STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2004-339

December 17, 2004

MAINE PUBLIC UTILITIES COMMISSION
Investigation into Central Maine Power Company's
Stranded Cost Revenue Requirements and Rates

EXAMINER'S
PROPOSED RULING
ON MOTION TO STRIKE

NOTE: This Examiner's Report is the Advisors' recommendation and does not constitute formal Commission action. Parties may make exceptions to this Report at oral argument scheduled for 1:30 on December 22, 2004. We anticipate that the Commission will consider this case at its deliberative session on that date.

I. SUMMARY

On December 3, 2004, Central Maine Power Company (CMP) filed a Motion to Strike a Portion of Advisory Staff's Phase II Bench Analysis. Specifically, in its motion, CMP seeks to strike Section IV of the Phase II Bench Analysis which relates to cost of capital issues and recommendations. The Office of the Public Advocate (OPA) filed its Response to CMP's Motion to Strike on December 9, 2004 which opposed the granting of CMP's motion. For the reasons set forth below we deny CMP's Motion to Strike.

II. POSITIONS OF THE PARTIES

A. CMP's Motion

In its motion, CMP argues that the Staff's cost of capital testimony is not proper rebuttal testimony, is untimely, and deprives CMP of its opportunity to respond in advance of hearing. CMP states that at the commencement of the proceeding, CMP proposed a list of issues to be addressed in the proceeding. Cost of capital was not identified as an issue to be addressed in this proceeding and the schedule did not include any provision for addressing cost of capital issues. CMP goes on to argue that CMP's proposal with respect to computing carrying costs on deferrals was clearly spelled out in its July 23, 2004 Phase I filing. Accordingly, Staff had ample notice of CMP's position and should have raised CMP's overall cost of capital in its Phase I Bench Analysis filed on September 14, 2004. CMP goes on that Staff's late-filed cost of capital proposal deprives CMP of its right to explore the justification of the proposal and to submit testimony and exhibits in rebuttal on the issue.

The Company also argues that, notwithstanding the timeliness issue, the Commission should strike Staff's recommended return on equity (ROE) for CMP because it is not supported by admissible evidence. CMP argues that the only evidence that the Staff offers in support of its ROE proposal is the expert testimony filed by BHE in its stranded cost proceeding and the Staff's analysis of that testimony. CMP asserts that at pages 11 through 19 of the Phase II Bench Analysis, Staff adopts wholesale what it prepared in BHE's case. Staff has offered no expert testimony addressing the specific circumstances of CMP nor has it even presented an expert in this proceeding whose analysis and findings would be subject to discovery and cross-examination. Rather Staff relies on the unsubstantiated hearsay (Dr. Strong's Testimony in BHE) for

its recommendation. This hearsay evidence is inadmissible as it is not the kind of evidence which reasonable persons are accustomed to rely on in the conduct of serious affairs and that it is not subject to cross-examination. In addition, CMP argues that the evidence is irrelevant and cannot be relied on by the Commission in this proceeding.

B. The OPA Response

In its response to CMP's motion, the OPA argues that CMP's motion is predicated on the argument that the cost of capital discussion in the Phase II Bench Analysis came as a surprise. The OPA notes that in its Phase I Bench Analysis, the Staff indicated that CMP's current weighed average cost of capital (WACC) which CMP proposed using, was "extremely outdated" and not appropriate to use in the context of this proceeding. The OPA continues that although the Staff proposed using a three-year bond rate on stranded cost balances, Staff's Phase I Bench Analysis was sufficient to put the Company on notice that the WACC was an issue. Second, the OPA notes that CMP, as a party to the BHE proceeding, was aware that BHE had filed a Motion in Limine to remove cost of capital as an issue in its stranded cost proceeding. The events in that proceeding, certainly put CMP on notice that cost of capital was at issue in its proceeding.

Responding to CMP's claim that addressing the WACC would require extra time and expense, the OPA notes that its office submitted a WACC proposal, through the pre-filed testimony of Stephen Hill, at the same time as the Phase II Bench

Analysis. The OPA notes that CMP has not challenged the admissibility of Dr. Hill's WACC testimony.

With regards to CMP's argument that the Staff's Phase II Analysis is inadmissible hearsay, the OPA acknowledges that the Staff's WACC proposal is unusual. However, by taking Dr. Strong's recommendation and making adjustments, it is not Dr. Strong's testimony that Staff relies on, rather it is Dr. Strong's approach as adopted and changed by the Staff. The OPA goes on to argue that the Maine PUC is eminently capable of understanding what the Staff has done.

III. DECISION

In its motion, CMP claims that the Phase II cost of capital analysis is improper rebuttal testimony because it is not in the nature of rebuttal.[1]

In its Phase I filing, the Company proposed a stranded cost reconciliation mechanism. Under the Company's proposal, carrying costs would accrue on balances deferred under the mechanism at its overall cost of capital. The Company's Phase I filing did not contain specific rate or revenue requirement proposals.

[1] At the outset, we would first note our disagreement with CMP's categorization of the Advisory Staff's Phase II Analysis as testimony. As its name implies, the Phase II Bench Analysis is our staff's independent analysis submitted pursuant to the provisions of 35-A M.R.S.A. 1305(5) and is not testimony of a witness.

On September 14, 2004, the Staff filed its Phase I Bench Analysis which stated its belief that CMP's current WACC established in Docket No. 97-580 was outdated. At the time of its Phase I proposal, it did not appear that there was any significant stranded cost rate base going into the new stranded cost rate-setting period. The Staff recommended that the appropriate carrying cost for CMP stranded cost deferrals would be based on a treasury bond rate, with the exact rate depending on the length of the deferral period.

In its Phase II Filing/Phase I Rebuttal, the Company presented two different revenue requirement scenarios. Under the first scenario, rates would be set in each of the next three years so that each year's rates would recover that particular revenue requirement. Based on CMP's rate proposals and the purchased power entitlement sales proxy provided by Staff at the time, CMP projected stranded cost revenue requirements to be $144 million, $128 million and $111 million during the next three years. Under the second scenario, revenue requirements would be levelized over the next three years, and rates would be set to recover the levelized revenue requirement. The Company stated that if the Commission moved to a one-year reconciliation mechanism as suggested by Staff, then the carrying cost rate for monthly fluctuations in stranded cost revenues and stranded costs should be CMP's actual short-term debt rate or in the absence of of short-term debt the temporary cash investment rate. If, however, the Commission continued to set stranded costs for more than one year, with or without reconciliation, then the adjustment to levelize stranded costs, as well as any deferrals, should be determined using CMP's overall cost of capital.

In its Phase II Bench Analysis, the Advisory Staff stated that given the likelihood that standard offer rates would increase significantly for CMP's customers in March 2005, the Staff supported CMP's three-year levelization approach. The Staff noted that in its Phase I Bench Analysis it had recommended that the carrying costs on assets deferred during the stranded cost period be based on the short-term treasury bond rate. The Staff stated that it agreed with CMP that should a three-year levelization approach be utilized the Company's WACC, based on current financial market and regulatory conditions should be used. The Staff's recommended WACC was then set forth in Section IV of the Bench Analysis.

We do not believe that the Phase II portion of this case was intended to be strictly limited to rebuttal presentations. Similar to past stranded cost rate proceedings, CMP proposed, and the Examiner ultimately adopted a multi-phase schedule in this case. The Phase I portion of the case has in the past served as an issue identification phase with the issues being completely developed during Phase II and in certain instances Phase III of the case. We believe that the schedule in this case was structured with a similar development of the issues in mind.[2] Therefore, we would not limit the Phase II presentations of CMP, the Staff or the parties to strictly rebuttal presentations. While we believe that it certainly would have been preferable had the Staff laid out its WACC proposal, at least as an alternative, in its Phase I filing, given the

[2] On this point we would note that in its Phase II Filing, CMP for the first time presented its sales forecast and rate proposals. In their Phase II responsive filings the Staff and the OPA both presented alternative forecasts.

dynamics of this case, with multiple phases and under which provided CMP with an opportunity to respond to both Staff's Phase I and Phase II filings, we do not find that Section IV of the Phase II Analysis constitutes impermissible rebuttal requiring that it be stricken.

As noted perviously, a multi-phase approach has been adopted in this case which contemplates a narrowing and defining of the issues as the case progresses. In its Phase II Analysis, the Staff agreed with the Company's argument that the overall WACC should be applied on the regulatory asset established in order to levelize stranded cost revenue requirements over the next three years but that the WACC relied on by the Company was not appropriate. The Company, through its Phase II rebuttal, has an opportunity to respond to Staff's Phase II proposal.

In addition, we do not believe that CMP is prejudiced by Staff's Phase II WACC presentation or, in the alternative, that the schedule can not be reasonably accommodated to ensure that the Company will not be prejudiced. Of particular note on this point, is that at the same time that the Staff submitted its Phase II Analysis, the OPA submitted the testimony of Stephen Hill which contained a cost of capital analysis and a WACC recommendation significantly different than that of the Company's recommendation and, in fact, fairly close to the Advisory Staff's Phase II Analysis recommendation. CMP has not moved to strike Mr. Hill's testimony and, presumably, will present a response to Mr. Hill's testimony in its Phase II rebuttal case. To the extent that CMP believes that it needs additional accommodations to respond to the Staff's

Phase II Analysis we will certainly entertain such a request and will modify the schedule as appropriate.

With regards to CMP's position that the Staff's Phase II Bench Analysis constitutes inadmissible hearsay, we find ourselves in agreement with the arguments presented in the OPA response. In its response, the OPA characterizes the Staff's WACC presentation as unusual but not inadmissible. As the OPA notes, the Staff's analysis is not Dr. Strong's testimony. Rather it is Dr. Strong's approach as adopted and changed by the Staff, that is being submitted. The OPA goes on to argue that:

> "Each utility has its own "regulatory" WACC. However, some utilities are so like others that the WACC of one strongly informs the other. This observation is supported by recognizing the use of peer groups of similar utilities in performing analyses like the DCF and CAPM. What the Staff has done merely recognizes this fact and uses the peer groups assembled by Dr. Strong on BHE's behalf as a beginning point to arrive at its own conclusions about what is applicable to CMP. This is certainly admissible and the utility is free to ask the staff how and why this was done without any need for Dr. Strong's presence. In this sense, Dr. Strong's testimony by itself is irrelevant to this proceeding. It is the Staff's changes to that approach and the result of those changes that are relevant. Moreover, any lack of understanding by the Staff of Dr. Strong's analysis on a given point (as it may affect Staff's adjustments) simply goes to the weight of the evidence not its inadmissibility."

In the case before us, Section IV of the Phase II Bench Analysis was prepared and submitted by Staff financial analyst, Richard Kivela. Under the provisions of 35-A M.R.S.A. § 1305(5) such analysis is subject to discovery and Mr. Kivela will be made

available to answer questions regarding those facts or analysis in the same manner as witnesses in the proceeding.

As such, CMP will be provided an opportunity to question Mr. Kivela on his methodology analysis and its applicability to CMP both as part of discovery and at the hearing stage. The evidence addressed during this process may ultimately convince us to provide little or no weight to Mr. Kivela's analysis. In addition, CMP may, based on the evidence adduced renew its motion that Mr. Kivela's analysis is so unreliable that it should not be admitted. At this time, however, based on the record before us, we do not accept CMP's argument that Section IV of the Bench Analysis constitutes unreliable inadmissible hearsay evidence.

Accordingly, it is

O R D E R E D

That CMP's Motion to Strike Section IV of the Phase II Bench Analysis is denied.

Dated at Augusta, Maine, this 17th day of December, 2004.

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Charles Cohen
Hearing Examiner

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James Buckley
Hearing Examiner